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August 31, 1979

TO COUNTY ASSESSORS:

LEASE AND LEASEBACK OF PUBLIC PROPERTY

In response to pending litigation in May 1977 a telephone survey of 22 selected counties was made in regard to the assessment of the situation wherein a public entity (city, county or district) leases land to a private contractor who constructs an improvement (city hall) and then leases the improvement back to the public entity. Although most counties responded that a possessory interest was assessed in that situation, a few were undecided or held the property to be exempt from taxation.

The provoking litigation recently became final in the case of City of Desert Hot Springs v. County of Riverside, 91 Cal. App. 3d 441 (1979), wherein the district court of appeal held that a lease-leaseback created a taxable possessory interest in the contractor. Specifically, the city leased a four and one-half acre parcel to the contractor for a term of 50 years for the consideration of one dollar. Upon completion of construction of a civic center complex possession was to be delivered to the city under a sublease for a term of 15 years with annual rental based on a maximum construction cost with options to purchase at the end of the fifth year or tenth year. Title to the parcel was retained by the city subject to the lease and sublease, but title to all structures was to remain in the contractor during the term of the sublease and to vest in the city at the end of the 50 year term. The original lease could terminate at the first occurrence of: (1) 35 years after the term of the sublease; (2) exercise of the option by the city; or (3) repayment by the city of all encumbrances.

The court's decision was based on a two step analysis. The original lease to the contractor clearly created a taxable possessory interest under Revenue and Taxation Code, section 107, and Property Tax Rule 21. The second step then considered whether the lease back to the city would have the effect of cancelling the interest created. The court reviewed prior cases wherein it was concluded that a private lessor of property leased to public

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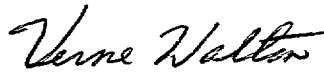
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entity may fairly be deemed to be the owner of the whole estate for purposes of taxation. Here the possession by the city under the sublease is not in opposition to the contractor's right under the original lease, but rather pursuant to and subordinate to his right. In lieu of actual occupancy of the premises he receives rental under the sublease which represents the value of the rented premises during the term of the lease.

Based on this decision all counties should review their rolls for lease and leasebacks of this type. If the situation exists, it should be classified as a taxable possessory interest and valued under the provisions of Revenue and Taxation Code, section 107.1, and Assessor's Handbook (AH-571).

Sincerely,



Verne Walton, Chief
Assessment Standards Division

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